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IN THE
Supreme Court of the United States

BENEFICIAL NATIONAL BANK, ET AL.,

Petitioners,

v.

MARIE ANDERSON, ET AL.,

Respondents.

On Writ of Certiorari To The United States Court of Appeals For the Eleventh Circuit

BRIEF *AMICI CURIAE* OF AARP, CONSUMER FEDERATION OF AMERICA, NATIONAL ASSOCIATION OF CONSUMER ADVOCATES, NATIONAL CONSUMER LAW CENTER & U.S. PUBLIC INTEREST RESEARCH GROUP IN SUPPORT OF RESPONDENTS

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BRIEF *AMICI CURIAE* OF AARP, CONSUMER FEDERATION OF AMERICA, NATIONAL ASSOCIATION OF CONSUMER ADVOCATES, NATIONAL CONSUMER LAW CENTER & U.S. PUBLIC INTEREST RESEARCH GROUP IN SUPPORT OF RESPONDENT

INTEREST OF *AMICI CURIAE*[1/]

AARP, Consumer Federation of America (CFA), National Association of Consumer Advocates (NACA), National

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[1/] Letters indicating the parties' consent to the filing of this brief have been filed with the Clerk of the Court. No counsel for any party authored this brief in whole or in part, and no person or entity other than *amici curiae*, their counsel, or their members made a monetary contribution to the preparation or submission of this brief.

Consumer Law Center (NCLC) and U.S. Public Interest Research Group (U.S. PIRG) ("*amici*") are organizations that devote a considerable amount of their work to advocating for the enactment and enforcement of strong state laws and regulations that protect consumers from exploitation in the credit marketplace. *Amici* recognize that low-income consumers, those whom mainstream lenders consider "high risk" borrowers, and consumers on fixed incomes often have difficulty finding credit on reasonable terms. They typically are relegated to high-cost lenders and non-traditional sources of credit, collectively referred to as the "fringe banking," "predatory lending," or "alternative financial sector" (AFS) industry where they often are subject to deceptive and unfair lending practices, such as hidden fees, exceedingly high interest rates, and extreme default penalties. Because the products that comprise these markets, including income tax refund anticipation loans (RALs) and payday loans, are particularly egregious and exploitative, *amici* have assisted in state legislative efforts to enact protections for consumers involved in these transactions, and have filed numerous *amicus curiae* briefs, often in support of state Attorney General and regulatory agency enforcement actions, urging courts to uphold these protections.

During their long histories as consumer advocates, *amici* have observed the need for enhanced protection of consumer rights and vigilant enforcement of laws designed for this purpose. RALs are just one in an array of products in a burgeoning industry that targets necessitous borrowers, the very people for whose protection usury limits exist. Yet, the companies that market these loans historically have engaged in a series of actions specifically designed to evade these protections. While their earlier actions involved disguising the true nature of the transactions and assigning labels other than loans to avoid disclosure and other statutory requirements, their association with national banks is just the latest in this series of efforts to circumvent these statutes.

AARP is a non-partisan, non-profit organization with more than 35 million members dedicated to addressing the needs and interests of people aged 50 and older. As the largest

membership organization serving this population, AARP is greatly concerned about unfair and deceptive financial products and services targeted at vulnerable consumers, including those related to mortgages, home equity loans, and other credit transactions. Because older Americans are disproportionately victimized by many of these practices, AARP supports laws and public policies to protect their rights in a broad range of marketplace transactions. Among these are measures that assure access to credit on fair and reasonable terms, prohibitions on oppressive conditions, and laws and regulations to protect consumers against deceptive and usurious credit practices. Due to its concerns about abuses in the alternative financial sector, AARP has published several reports on the issues involved and measures needed to protect consumers from lenders' most egregious practices. *See, e.g.*, Sharon Hermanson & George Gaberlavage, AARP, *The Alternative Financial Services Industry* (2001), and Elizabeth Renuart, AARP, *Payday Loans: A Model State Statute* (2000).

Consumer Federation of America (CFA) is a non-profit association organized in 1967 to advance the interests of consumers through advocacy and education. CFA's current membership is comprised of almost 300 national, state, and local consumer groups throughout the United States which, in turn, represent more than 50 million consumers. Recognizing the phenomenal growth and high cost of short-term consumer credit, CFA has made protecting the interests of individual consumers in this credit market a priority. CFA has published a series of reports on developments in the check cashing industry and the payday loan and RAL sectors, and advocates on credit consumer protections and application of payment method protections to prevent fraud and provide redress. *See, e.g.*, Jean Ann Fox & Edmund Mierzwinski, Consumer Fed'n of Am. & U.S. Pub. Interest Research Group, *Rent-A-Bank Payday Lending – How Banks Help Payday Lenders Evade State Consumer Protections* (2001). CFA is particularly concerned that effective consumer protections and disclosure rules serve consumers who obtain credit in the alternate financial sector.

The National Association of Consumer Advocates (NACA) is a non-profit organization whose members are private and public sector attorneys, legal services attorneys, law professors and students whose primary practice and areas of specialty involve consumer protection issues. NACA has appeared as *amicus curiae* in numerous federal and state court proceedings. Its mission is to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country and to serve as a voice for its members, as well as consumers, by curbing unfair and abusive business practices that adversely affect consumers.

The National Consumer Law Center, Inc. (NCLC) is a non-profit corporation established in 1969 to carry out research, education, and litigation regarding significant consumer matters. One of NCLC's primary objectives is to assist attorneys in representing the interests of their low-income and elderly clients in the area of consumer law. A major focus of NCLC's work has been to increase public awareness of, and to advocate protections against, high-cost loans and other forms of abusive credit extended to low-income consumers. NCLC publishes *The Cost of Credit: Regulation and Legal Challenges* (2d ed. 2000 & Supp. 2002), and *Truth in Lending* (4th ed. 1999 & Supp. 2002), among its many other treatises, to assist attorneys whose clients have been victimized by unfair, fraudulent, or deceptive lending practices. In addition, NCLC has directly assisted attorneys in scores of cases brought under federal and state credit protection statutes. The Federal Trade Commission (FTC) designated NCLC as the consumer representative in proceedings that led to the agency's promulgation of its Rules on Preservation of Consumers' Claims and Defenses, 16 C.F.R. Pt.433 (1998), and Credit Practices, 16 C.F.R. Pt.444 (1998).

The U.S. Public Interest Research Group (U.S. PIRG) serves as the national association of state Public Interest Research Groups. State PIRGs are non-profit, non-partisan consumer advocacy groups with a long history of supporting the strongest possible consumer protections against predatory financial practices. In addition to state and federal advocacy and publication of research reports and consumer education

materials about predatory lending, the state PIRGs have participated as *amicus curiae* in numerous cases opposing federal preemption of stronger state and local consumer laws.

Amici submit this brief in support of Respondents to inform the Court about the key products offered in the alternative financial sector and the widespread harm to the nation's vulnerable borrowers that will result if companies in this market are allowed to avoid compliance with state usury, small loan, and similar laws by partnering with national banks.

SUMMARY OF ARGUMENT

Low-income consumers and those whom mainstream lenders consider "high risk" often cannot find credit in the traditional market. Particularly when they need money in an emergency, they must rely on high-cost lenders and non-traditional sources of credit, collectively referred to as the "alternative financial sector" (AFS). Refund anticipation loans (RALs), payday loans, and automobile title pawns are the most common products offered in this market, at extremely high interest rates – triple digit and higher annual percentage rates (APRs) on these products are typical.

AFS lenders historically have characterized their products in various guises, attempting to avoid being subject to usury and other state interest rate limits. Most of these efforts involved disguising the true nature of the transactions and using labels other than loans. As courts and regulators uniformly looked at the substance of the transactions to reject these ruses, the lenders began to associate with national banks to take advantage of their ability to export their home state's interest rate to other states in which they make loans.

The AFS targets consumers most vulnerable to exploitative practices and least able to protect their interests. Usury, small loan, and other state consumer protection statutes are designed to protect these consumers, who often have little choice but to turn to these lenders due to their limited bargaining power and financial desperation. *See, e.g., Schneider v. Phelps*, 359 N.E.2d 1361, 1365 (N.Y. 1977) ("The purpose of usury laws,

from time immemorial, has been to protect desperately poor people from the consequences of their own desperation. . . . Lenders, with the money have all the leverage; borrowers, in dire need of money, have none."). Consumers who must resort to these lenders are among those with the greatest need for a marketplace that operates with integrity and the enforcement of state laws enacted for their especial benefit.

ARGUMENT

I. THE "ALTERNATIVE FINANCIAL SECTOR" EXPLOITS VULNERABLE CONSUMERS WHO MUST RELY ON APPROPRIATE STATE REGULATION OF THEIR PRACTICES

A. The Nature of the Marketplace

In order for the Court to fully appreciate the implications of its decision, it is important to understand the nature of the market in which RALs are offered. These loans are part of an industry popularly referred to as "fringe banking" or the "alternative financial sector" (AFS). *See* Roger Swagler, et al., *The Alternative Financial Sector: An Overview*, 7 Advancing the Consumer Interest 7 (1995); John R. Burton, et al., *The Alternative Financial Sector: Policy Implications for Poor Households*, 42 Consumer Interests Annual 279, 279 (1996). The AFS targets low-income, working poor, and minority consumers, and those with blemished credit histories, who cannot access traditional sources of money, credit, or certain consumer goods. This has resulted in the establishment of a two-tiered economy, often referred to as a system of "financial apartheid" or the "second-class" marketplace, in which middle-income and affluent consumers are served by federally-insured and regulated banks, and the poor and near-poor are relegated to expensive and, in many cases, poorly regulated alternatives. *See* Lynn Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. Rev. 589, 591 (2000) [hereinafter Drysdale & Keest].

While many consumers have other ways to obtain short-term, unsecured loans, such as credit cards and checking accounts with overdraft lines of credit, the poor and near-poor lack access to these traditional sources of credit. A recent Federal Reserve survey found that approximately one-fourth of families did not have a credit card, and that despite widespread use of credit cards for borrowing, people in the lowest income group, families headed by persons sixty-five and older, and those who are not working are among the groups for whom such use is "notably lower." Ana M. Aizcorbe, et al., *Recent Changes in U.S. Family Finances: Results from the 1998 and 2001 Survey of Consumer Finances*, Fed. Res. Bull. 24-25 (2003), *available at* http://www.federalreserve.gov/pubs/bulletin/2003/0103lead.pdf. Coupled with the decline in the availability of small, unsecured loans from banks and finance companies, many consumers, particularly those with modest incomes or impaired credit, find that the AFS represents their only source of this type of credit. Well aware that they serve as one of the few ways these consumers can get necessary cash, lenders in this market maintain they merely are filling the credit gap created by traditional lenders. Even if this were a legitimate argument, and *amici* do not concede that it is, the provision of a necessary service neither justifies the practices that harm the very consumers these lenders claim to help nor supports providing them with a reduced level of legal protections.

A primary segment of the AFS features products that allow consumers to obtain an advance of a relatively small amount of cash, with repayment deferred for a relatively short period. The three main forms of these cash advances – RALs, payday loans, and auto title pawns – share the fact that they are extremely expensive, with triple digit annual percentage rates (APRs).

RALs – These loans provide cash against a customer's anticipated income tax refund. The cash advance is less than the expected refund, and the business that makes the advance keeps the difference. RALs generally are made by banks, including national banks, with tax preparers acting as loan brokers soliciting and facilitating the transaction. RAL

taxpayers generally are required to file their federal tax returns electronically, making the anticipated repayment period approximately ten days, at which time the business that advanced the money receives the full refund from the IRS. If the refund is less than the amount anticipated, the borrower is liable for the difference. RALs are very costly, in part because borrowers actually pay three fees: a tax return preparation fee, typically ranging from $60 to $300, paid to the commercial tax preparer; an electronic filing fee which averages $40; and a loan fee to the lender, generally set on a sliding scale based on the amount of the expected refund. *See* Chi Chi Wu, et al., Consumer Fed'n of Am. & Nat'l Consumer Law Center, *Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed From the Working Poor & U.S. Treasury* 5 (2002), *available at* http://www.nclc.org/initiatives/refund_anticipation/content/RAL_final.pdf. The cash advanced to the borrower is the refund minus the total of these fees.

Approximately 12.1 million RALs were made during the 2001 tax-filing season, and borrowers paid an estimated $907 million in RAL fees, an additional $484 million in electronic filing fees, and $400 million in document preparation or application fees, for a total of $1.8 billion. *See* Chi Chi Wu & Jean Ann Fox, Nat'l Consumer Law Center & Consumer Fed'n of Am., *The High Cost of Quick Tax Money: Tax Preparation, 'Instant Refund' Loans, and Check Cashing Fees Target the Working Poor* 1, 3 (2003), *available at* http://www.nclc.org/initiatives/refund_anticipation/content/2003_RAL_report.pdf. In addition to the aggregate figures, these loans are costly to the individual borrower: the loan fee charged on a ten-day loan costs from 97.4% to more than 2,000% APR, with the loan fee to borrow against the average $2,000 refund equaling an APR of 222.5%. *Id.* at 4.

Moreover, because refunds paid to RAL borrowers often include the Earned Income Tax Credit (EITC),[2/] a federal

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[2/] A recent report found that in tax year 1999, in some cities more than 50% of EITC recipients obtained RALs and nearly half the $30 billion in EITC claimed nationwide was refunded through RALs. *See* Alan Berube, Brookings Inst., *Rewarding Work Through the Tax Code: The Power and Potential of the Earned Income Tax Credit in 27 Cities and Rural Areas* 4, 10 (2003), *available at* http://www.brookings.org/dybdocroot/es/urban/publications/berubetaxcodenomaps.pdf.

benefit for low-income working families generally distributed in a lump sum, these huge interest rates divert considerable sums from federal benefits intended for these taxpayers. A recent report, using IRS data, concluded that for tax year 1999, the combined fees paid for RALs drained $1.75 billion from benefits that otherwise would have gone to taxpayers who qualified for the EITC. *See* Alan Berube, et al., The Brookings Inst., *The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC* 11 (2002), *available at* http://www.brookings.edu/dybdocroot/es/urban/publications/berubekimeitc.pdf.

Several states regulate tax preparers that make RALs, either through statutes that apply to them specifically or those that regulate loan brokers. *See, e.g.*, N.C. Gen. Stat. §§ 53-245 to 53-254; Letter from Thomas J. Curry, Mass. Comm'r of Banks, "Division of Banks Warns Tax Preparers" (Mar. 5, 2003), *available at* http://www.state.ma.us/dob/taxprep.htm (invoking Massachusetts statute requiring loan brokers to abide by 23% interest rate cap). Tax preparers are not subject to any national standards. *See* Nat'l Taxpayer Advocate, I.R.S., *FY 2002 Annual Report to Congress* 216 (2002), *available at* http://www.irs.gov/pub/irs-utl/nta_2002_annual_rpt.pdf.

Auto title pawns – Pawnbroking is one of the oldest sources of credit for financially marginalized people. Yet, the last several decades have seen both an increase in the number of pawn shops as well as variations on the traditional transaction, the leading one being the auto title pawn or title loan. Standard pawn transactions are structured as pledges or conditional sales of property in which the pawnbroker takes possession of the pledged or "sold" property and pays the customer. The customer has the right to redeem the property by paying a higher amount, usually a month later, but has no obligation to do so. Pawnbrokers generally are regulated by state pawnbroker

statutes, and in some states are exempt from usury limits. Auto title pawns emerged as an effort to take advantage of this favorable treatment, but the transaction differs from the traditional one in a substantial way, namely, the car owner pawns the title and keeps the car. In effect, therefore, these pawns constitute a small loan secured by a non-purchase money interest in the borrower's car. *See* Drysdale & Keest, *supra*, at 597. Lenders usually advance no more than one-third the book value of the vehicle and charge fees based on a percentage of the amount borrowed for a one-month term; APRs typically range from 200% to 300%. *Id.* at 599. If, as often happens, borrowers cannot pay the principal and interest on the due date, they can pay another fee to extend the loan; if they default, the lender can repossess the car.

Payday loans[3/] – As described more fully in the next section, payday lenders advance small amounts of money either by taking a post-dated check from which they withhold a fee and lend the balance or by having the borrower authorize an automatic debit from his or her bank account. The lender agrees to hold the check or not debit the account for a certain period, usually two weeks. When the loan term expires, the lender can deposit the check or debit the account, or the borrower can pay the lender the full face amount of the check in cash or money order. So, for example, a borrower writes a check for $115 and receives $100 in cash. At the end of the two-week period, the borrower pays the lender $115 to redeem the check, or authorizes the lender to deposit it. If the borrower cannot repay the loan when it becomes due, he or she can roll it over or extend the term by paying another fee without receiving additional cash. As discussed more fully below, triple digit APRs for a typical two-week loan far exceed state usury and small loan limits; fees paid to roll over loans send the APR even higher.

[3/] These loans also are referred to as "deferred deposit," "deferred presentment," "cash advance," "payroll advance," "check advance," and "post-dated check" loans.

B. The Evolution of Payday Loans Demonstrates Both Their Abusive Nature and Lenders' Ruses to Evade State-Imposed Interest Limits

1. Historical Background

As described above, payday loans are small, short-term, high-interest loans whose repayment generally is tied to the borrower's next pay day. These loans have direct precursors in loans made against a borrower's wages. As salaries increased to the point they covered necessities and provided a surplus to pay principal and interest on debts, "prospective salaries and wages became assets, however inchoate, against which loans could be made." Rolf Nugent, *The Loan-Shark Problem*, 8 Law & Contemp. Probs. 3, 4 (1941). The "five-for-six-boys" lent $5.00 at the beginning of the week, to be repaid with $6.00 on the borrower's next payday, one or two weeks later. *See* Drysdale & Keest, *supra*, at 618. In some instances, "salary buyers" would "buy" the borrower's next wage packet at a discount, for example, advancing $22.50 in exchange for the "sale" of a $25.00 paycheck two weeks later (with an APR of 311%). *Id.* at 618-19. Another practice involved having the borrower sign a bank check covering the loan principal and interest. The check was drawn on a bank in which the borrower did not have an account, and the lender said the check was "security" and would not be cashed but would be returned to the borrower when the loan was repaid. If the borrower defaulted, the lender deposited the check and threatened to prosecute the borrower when the bank refused payment. *See* Joe B. Birkhead, *Collection Tactics of Illegal Lenders*, 8 Law & Contemp. Probs. 78, 86 (1941).

These types of loans were short-term, with two weeks being the most common period. William H. Simpson, *Cost of Loans to Borrowers Under Unregulated Lending*, 8 Law & Contemp. Probs. 73, 73 (1941). While the interest rates on these loans were usurious, borrowers generally did not know their rights or have access to the courts, resulting in few challenges. "The one who suffers most at the hands of high-rate lenders is the borrower, yet he is almost the only member of society who has done nothing about his plight." Drysdale & Keest, *supra*, at 619-20 (citing George L. Gisler, *Organization of Public Opinion*

for Effective Measures Against Loan Sharks, 8 Law & Contemp. Probs. 182, 182 (1941)).

Despite the high cost, people in financial distress renewed these small loans, entering a downward spiral mirrored by today's payday borrowers. *See* Drysdale & Keest, *supra*, at 620. The dire situation in which these borrowers found themselves led to legislative efforts to regulate the lenders. What emerged was a legal framework that permitted a high enough return to attract legitimate businesses into the small loan market, with sufficient safeguards to prevent the abuses that prevailed among "loan sharks." *Id.* at 621 (citing Frank B. Hubachek, *Annotations on Small Loans: Based on the Sixth Draft of the Uniform Small Loan Law* 1-3 (1938)). While lenders argued that these transactions involved property purchases and thus were not governed by usury laws, the Uniform Small Loan Laws adopted by many states between 1916 and 1935 defined them as cash lending, subjecting them to small loan regulation. *See* John P. Caskey, *Fringe Banking: Check Cashing Outlets, Pawn Shops, and the Poor* 31-32 (1994) [hereinafter Caskey]. Every state except Arkansas enacted small loan laws, with Arkansas capping interest in its constitution. Drysdale & Keest, *supra*, at 621.

2. Contemporary Payday Lending

In its current form, payday loans involve the borrower writing a personal check payable to the lender and receiving cash minus a fee. The lender and borrower both know the borrower does not have sufficient funds in his or her account to cover the check, and the lender agrees to hold the check until the borrower's next payday or another designated date. At the end of the initial loan term, usually one or two weeks, the customer can redeem the check by paying the face amount, allow the check to be cashed, or refinance ("roll over") the loan by paying another fee. Payday loans are marketed as a quick, easy way to obtain cash. To qualify, borrowers need only maintain a personal checking account, be employed for a specified period with their current employer, and show a pay stub and bank statement. Lenders do not routinely conduct credit checks or make other inquiries into the borrowers' ability to repay. Annualized interest rates

average around 500%. *See generally* Nat'l Consumer Law Center, *The Cost of Credit: Regulation and Legal Challenges* (2d ed. 2000 & Supp. 2002) at §§ 7.5.5 & n.357, 7.5.5.3. While lenders have argued that the absolute dollar amounts are small, not only are these loans still expensive given their short term, but frequent rollovers and the use of multiple high-cost credit sources by payday loan customers collectively drain significant amounts of money from the budgets of economically fragile families.

There has been an explosive growth in payday lending in the United States since the industry emerged in the early 1990s. *See* Scott A. Schaaf, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. Banking Inst. 339, 339 (2001) [hereinafter Schaaf]. It is estimated that more than 10,000 payday loan outlets are operating, and Stephens, Inc., a Little Rock, Arkansas investment firm, predicted that by 2002 there would be 25,000 stores that would generate $6.75 billion annually in *fees alone*. *See* U.S. Pub. Interest Research Group & Consumer Fed'n of Am., *Show Me the Money! A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures* 8 (2000), *available at* http://www.pirg.org/reports/consumer/payday/showmethemoneyfinal.pdf [hereinafter *Show Me the Money!*]. Stephens, Inc. also forecasted that "the annual volume of business will total 180 million transactions with $45 billion volume of loans to produce that $6.75 billion in fee volume." *Id.* (citing Stephens, Inc., *The Developing "Payday Advance" Business: The Next Innings: From Emergence to Development* 9 (1999)).

This growth has been tied to the deregulation of the banking industry, the lack of traditional lenders in the small loan, short-term credit market, and the elimination of interest rate caps. *See* Lisa B. Moss, *Modern Day Loan Sharking: Deferred Presentment Transactions & The Need For Regulation*, 51 Ala. L. Rev. 1725, 1732 (2000) (citing Nat'l Consumer Law Center, *Special Issue: Check Cashers, Pay Day Loans and Pawns*, 16 NCLC Reports, Consumer Credit & Usury Ed. 13-14 (1998)) [hereinafter Moss, *Modern Day Loan Sharking*]. Deregulation in the 1980s led banks to eliminate less profitable services, such as free checking and small balance accounts, leaving millions of

low-income households with little access to free financial services. *Id.* As mainstream institutions moved out of the small loan market due to higher returns on larger loans, payday lenders filled the void. *Id. See also* Schaaf, *supra*, at 340-41. In addition to an increased number of stand alone payday lenders, the recent surge in the number of payday loans also can be attributed to the entry into the market by check cashing outlets, convenience stores, gas stations, and pawn shops, as well as offers on the Internet. *Show Me the Money!*, *supra*, at 8.

3. Lenders' Relationships With National Banks Are Just the Latest in a History of Attempts to Evade Interest Caps

Payday lenders have devised a number of contrivances in order to assert that usury laws do not apply because they are not making loans. Initially, many lenders argued that they did not make loans or charge interest at all, but simply charged "fees" for the financial service of cashing checks. Under this "delayed presentment" check cashing arrangement, payday lenders claimed that since they were not lending money, they were not subject to federal and state laws that regulate extensions of credit, require licensing and certain disclosures, and limit the interest that lenders can charge to levels substantially below the triple digit rates most of them charged. Courts uniformly have rejected the pretense that payday lenders were not making loans when they delayed depositing a consumer's checks in exchange for a fee. *See, e.g.*, *Turner v. E-Z Check Cashing of Cookeville, TN, Inc.*; 35 F. Supp. 2d 1042 (M.D. Tenn. 1999); *Hamilton v. York*, 987 F. Supp. 953 (E.D. Ky. 1997); *In re Miller v. HLT Check Exchange*, 215 B.R. 970, 1997 Bankr. LEXIS 2107 (E.D. Ky. 1997); *Livingston v. Fast Cash USA, Inc.*, 753 N.E.2d 572 (Ind. 2001); *White v. Check Holders, Inc.*, 996 S.W.2d 496 (Ky. 1999); *Quick Cash, Inc. v. State Dep't of Agric. & Cons. Servs.*, 605 So. 2d 898 (Fla. Dist. Ct. App. 1992).

The United States Federal Reserve Board similarly rejected payday lenders' assertions that the delayed presentment transactions involved only "fees" rather than "interest" on loans, and mandated that payday lending include interest rate and other

disclosures required by the Truth in Lending Act. *See* Comptroller of the Currency, *Regulation Z Truth in Lending: Final Rule Revision to Official Staff Commentary*, 2000 OCC CB LEXIS 22 (2000); 65 Fed. Reg. 17,129 (Mar. 31, 2000).

As courts and regulators rejected the pretense that these transactions were not loans involving interest charges, the industry developed new schemes. For example, in the modern equivalent of a scam used in the 1930's and 1940's by lenders trying to charge usurious interest rates, *see Willis v. Buchman*, 199 So. 886 (Ala. Ct. App.), *rev'd for mootness*, 199 So. 892 (Ala. 1940), some payday lenders labeled their loans as "catalog sales," "gift certificates," or "retail sales" of merchandise. In a typical scenario, the borrower gave the lender a post-dated check for $130. The lender agreed to hold the check for two weeks and gave the borrower $100 in cash and $30 worth of gift certificates or merchandise coupons. The amount of the coupons or certificates equaled the difference between the cash received by the borrower and the face amount of the check. If the borrower wanted to redeem the coupons or certificates, she or he had to return to the lender to place the order, at which time the lender charged the consumer additional fees, such as shipping and handling, a mark up, and sales tax. Not only would the lender not have received any of the add-ons if the consumer made the same purchase directly from the catalog wholesaler, but the added charges often made the merchandise unaffordable so that the consumer never redeemed the coupons or certificates. The lender thus kept their full value as profit. *See* Moss, *Modern Day Loan Sharking*, *supra*, at 1729-30. On the two-week $100.00 loan, the $30 certificate translated to an APR of 780%. *See, e.g., Cashback Catalog Sales, Inc. v. Price*, 102 F. Supp. 2d 1375, 1379 (S.D. Ga. 2000).

Another scheme, the "cashback ad," involves the pretense that the interest paid actually is purchasing an ad in a publication distributed by the lender. *See* Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 Minn. L. Rev. 1, 20 (2002) (citing Ruth Cardella, Consumers Union, *Wolf in Sheep's Clothing: Payday Loans Disguise Illegal Lending* 3 (1999), *available at* http://www.consumer.org/pdf/paydayloans.pdf. For example, a consumer who wants to borrow $100 has to pay an

advertisement fee of $33. The lenders maintain that they are charging a fee for the sale of a service and insist that the consumer pay for an ad in order to receive cash. The lender holds the consumer's check as a "security deposit" and "rebates" it when the consumer repays the loan two weeks later. If the consumer cannot repay the loan when it is due, he or she must renew the loan by paying an additional fee to purchase another ad. In one case, after six ad purchases, the lender guaranteed no further purchases would be necessary. The APR on these "ad" loans was 860%. *See* Drysdale & Keest, *supra*, at 604 (discussing Memorandum in Support of Plaintiffs' Motion for Class Certification in *Rodriguez v. Cash Today, Inc.*, No. C-99-305, *cert. granted*, 199 F.R.D. 566 (S.D. Tex. 2000); *see also Texas v. Cash Today, Inc.*, No. 99-02673 (Tex. Dist. Ct. Dec. 17, 1999).

In response to the wholesale rejection by courts and regulators of these ruses, payday lenders, tax preparers, and others, devised the "rent-a-bank" scheme through which to market their high-interest loans. By associating with a national bank, and claiming the bank is the lender, the check cashing outlet, tax preparer, etc., seeks to take advantage of the national bank's ability to export its home state's interest rate and thus to evade the usury and other interest rate caps imposed in the states where they do business. *See Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978). State regulators and borrowers have brought lawsuits seeking to pierce this ruse by proving that the check cashing outlet or other payday vendor is the true lender, notwithstanding its representations to borrowers that the national bank is the lender and the appearance of the bank's name on loan documents. *See, e.g., Purdie v. ACE Cash Express & Goleta Nat'l Bank*, CA No. 301-CV1754-X (N.D. Tex. filed Sept. 6, 2001); *Brown v. ACE Cash Express*, CA No. 24-C-01-004036 (Md. Cir. Ct. filed Aug. 20, 2001); *State ex rel. Ken Salazar, Att'y Gen. v. ACE Cash Express, Inc.*, Case No. 01CV3739 (Colo. Dist. Ct. filed July 13, 2001); *State ex rel. Roy Cooper, Att'y Gen. v. ACE Cash Express, Inc.*, No. 02-CVS-330 (N.C. Super. Ct. filed Jan. 14, 2002); *Long v. ACE Cash Express*, No. 00837-CA (Fla. Cir. Ct. filed Nov. 1, 2000). The lawsuits allege that the payday vendor possesses all the indicia of being the lender, namely, that it takes loan applications,

selects the credit scoring criteria, determines borrower eligibility, disburses loan proceeds, collects principal and interest from the borrower, and assumes the risk of non-payment. This form of lending has been dubbed "rent-a-bank" or "rent-a-charter" lending because the bank's only real participation is to lend its name and national charter to the transaction for a one or two-day period.

C. State Laws Protect Consumers From The Exploitative Practices of the AFS

Americans benefit from strong consumer protections in the marketplace that enhance their economic security. The growth of the fringe banking industry, specifically targeting consumers most vulnerable to predatory financial practices and least able to protect themselves from abuse, warrants stronger regulation and the rejection of exploitative lenders' attempts to evade these protections.

A large percentage of consumers who use fringe banks have no reasonable alternatives. They may need money immediately to pay rent or repair a car to get to work. Caskey, *supra*, at 78. Lack of education often is another factor in many consumers' decisions to use fringe banks, as consumers with lower education levels are likely to have limited knowledge of credit transactions. The National Institute for Literacy, an interagency group comprised of the U.S. Departments of Education, Labor, and Health and Human Services, found a total of 21% to 23% – or 40 to 44 million – of the 191 million American adults aged 16 or older perform at the lowest math and reading literacy level. Stephen Reder, Nat'l Inst. for Literacy, *The State of Literacy in America: Synthetic Estimates of Adult Literacy Proficiency at the Local, State and National Levels* (1998), *available at* http://www.nifl.gov/reders/!intro.htm.

AFS consumers frequently are at a distinct disadvantage because of limited education, bargaining power, and financial desperation. Many of them also mistakenly believe that despite good credit histories, that their low-income alone will disqualify them for more reasonably priced credit. For these reasons, vulnerable consumers need special protection. This is the basis

for usury laws and other more recent state statutes regulating the fringe banking industry. Usury laws have, for hundreds of years, been enforced to "protect the needy from the greedy." Drysdale & Keest, *supra*, at 657. For example, more than a century ago, a court stated:

> "These statutes were made to protect needy and necessitous persons from the oppression of usurers and monied men, who are eager to take advantage of the distress of others; while they, on the other hand, from the pressure of their distress, are ready to come to any terms; and with their eyes open, not only break the law, but complete their ruin."

Whitworth & Yancy v. Adams, 26 Va. (5 Rand.) 333, 335 (1827) (quoting *Brown v. Morris*, Cowp. Rep. 792). *See also Schneider v. Phelps*, 359 N.E.2d 1361, 1365 (N.Y. 1977) ("The purpose of usury laws, from time immemorial, has been to protect desperately poor people from the consequences of their own desperation. Law-making authorities in almost all civilizations have recognized that the crush of financial burdens causes people to agree to almost any conditions of the lender and to consent to even the most improvident loans. Lenders, with the money, have all the leverage; borrowers, in dire need of money, have none."); *Scarr v. Boyer*, 818 P.2d 381, 383 (Mont. 1991) ("usury statutes protect borrowers who lack real bargaining power against overreaching by creditors.").

Consumer protection laws reflect the fact that the consumer credit marketplace lacks equal bargaining power, equal knowledge, and a level playing field with respect to negotiating leverage. *See, e.g., In re Jordan*, 91 B.R. 673, 688 (Bankr. E.D. Pa. 1988) ("It is not surprising that interested, sophisticated lenders consistently interpret ambiguous laws to their own advantage and to the disadvantage of their obviously less-sophisticated customers. This data only highlights [sic] the need of the disinterested courts to be vigilant to prevent industry-wide overreaching."). These inequalities are more pronounced in the AFS than in the mainstream consumer credit marketplace, and consumers who resort to these products are among those with the greatest need for a marketplace that operates with integrity and

the enforcement of laws state legislatures intended for their protection. Lenders in the AFS should not be able to evade the usury, small loan, and other interest rate limits that states have designed to protect necessitous consumers from these lenders' exploitative practices.

Moreover, a ruling by the Court that the National Bank Act completely preempts state usury claims also will effectively remove regulation of non-bank small loan lenders from the states, where it traditionally has existed. These lenders will be able to escape accountability in the courts of their own states simply through the ruse of a "rent-a-bank" arrangement. Complete preemption will prevent states from seeking relief from courts in their own states, applying solely their own state laws, to regulate tax preparers that broker RALs and payday lenders and others that rent national bank charters.

CONCLUSION

Amici curiae respectfully urge the Court to affirm the Eleventh Circuit and allow vulnerable consumers the protection of state usury and other laws enacted for their benefit.

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